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No. 06-1667

In the Supreme Court of the United States

CHARLES PHELPS, JR., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether, under Sentencing Guidelines § 2T1.1, the amount of income tax loss a defendant intends to cause by a scheme to defraud should be reduced to the extent that he inadvertently causes payment of excess social-security taxes.

TABLE OF CONTENTS

Page

Opinion below 1
Jurisdiction 1
Statement 1
Argument 4
Conclusion 8

TABLE OF AUTHORITIES

Cases:

Braxton v. *United States*, 500 U.S. 344 (1991) 5
United States v. *Booker*, 543 U.S. 220 (2005) 2, 5
United States v. *Chavin*, 316 F.3d 666 (7th Cir. 2002) 4, 6
United States v. *Gordon*, 291 F.3d 181 (2d Cir. 2002), cert. denied, 537 U.S. 1114 (2003) 5, 6, 7
United States v. *Martinez-Rios*, 143 F.3d 662 (2d Cir. 1998) 4, 5
United States v. *Spencer*, 178 F.3d 1365 (10th Cir. 1999) 4, 6

Statute and guideline:

18 U.S.C. 371 ..... 1, 2
United States Sentencing Guidelines:
§ 2T1.1 ..... 4, 5
§ 2T1.1(c)(1) 4, 6

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1-6) is reported at 478 F.3d 680.

JURISDICTION

The judgment of the court of appeals was entered on February 12, 2007. A petition for rehearing was denied on March 16, 2007 (Pet. App. 17-18). The petition for a writ of certiorari was filed on June 13, 2007. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a guilty plea in the United States District Court for the Western District of Texas, petitioner was convicted of one count of conspiracy to defraud the United States, in violation of 18 U.S.C. 371. He was sentenced to 36 months of imprisonment, to be followed by

three years of supervised release. The court of appeals affirmed. Pet. App. 1-6.

1. Petitioner managed various adult-entertainment businesses that he co-owned with John Kenneth Coil. Pet. App. 1-2. A grand jury sitting in the Western District of Texas returned a 32-count indictment charging petitioner, Coil, and others with racketeering, mail fraud, various offenses related to obscene materials, and conspiracy to defraud the United States. Gov't C.A. Br. 2-3. Ultimately, petitioner pleaded guilty to one count of conspiracy to defraud the United States by impeding the Internal Revenue Service (IRS) in its computation, assessment, and collection of revenue, in violation of 18 U.S.C. 371. Gov't C.A. Br. 3.

The conspiracy charge to which petitioner pleaded guilty was based on petitioner's failure to report as income money that petitioner received from his businesses between 1997 and 2002. Pet. App. 19-23. Petitioner enlisted members of his family to falsely report that money as wage, dividend, and interest income on their tax returns. Petitioner sent funds to his family members to pay for the additional tax reflected on their tax returns. Petitioner's acts, which concealed the true source and disposition of petitioner's income from his businesses, constituted an attempt to impair and impede the IRS's ability to assess and collect the taxes that petitioner owed. *Ibid.*

2. Petitioner was initially sentenced to 42 months of imprisonment. After this Court's decision in *United States* v. *Booker*, 543 U.S. 220 (2005), the court of appeals remanded the case to the district court for resentencing. Pet. App. 2.

3. On remand, the district court determined that petitioner intended to cause a personal income tax loss

of more than $80,000 but less than $200,000, which corresponded to a base offense level of 16 under the advisory Sentencing Guidelines. Pet. App. 2-3. After the imposition of pertinent enhancements, the total offense level was 20, which yielded an advisory Guidelines range of 33 to 41 months. Gov't C.A. Br. 8. Petitioner was sentenced to 36 months of imprisonment, to be followed by three years of supervised release. Pet. App. 8-9.

4. The court of appeals affirmed. Pet. App. 1-6.

The court of appeals rejected petitioner's claim that the district court erred in calculating the tax loss. Petitioner argued that the loss caused by his underpayment of personal income tax should be reduced by the amount of social-security tax paid on the money fraudulently reported as wages of petitioner's family members, which petitioner's expert calculated as being $42,250. According to petitioner, because he had already paid the maximum annual social-security tax with respect to the wage income he did report, he would not have paid additional social-security tax if the money assigned to his family had instead been reported as his wages. Petitioner contended that he should be credited with $42,250 in social security tax, which would reduce the total tax loss to $38,213, the total offense level to 18, and the advisory Guidelines range to 27 to 33 months. Pet. 6-7; Pet. App. 27.

The court of appeals held that, for sentencing purposes, the "tax loss is the intended loss, not the government's actual loss." Pet. App. 4. It explained that the amount of income tax loss petitioner intended to cause should not be reduced "simply because his scheme to defraud apparently inadvertently caused payment of excess social security taxes." *Id.* at 6. Because the district court found that the income tax loss intended by

petitioner exceeded $80,000, the court of appeals concluded that it appropriately calculated petitioner's sentence based on that amount. *Ibid.*

In so holding, the court of appeals rejected petitioner's reliance on *United States* v. *Martinez-Rios*, 143 F.3d 662 (1998), in which the Second Circuit interpreted Sentencing Guidelines § 2T1.1 as giving a "defendant the benefit of legitimate but unclaimed deductions" in the calculation of tax loss. Pet. App. 5 (quoting *Martinez-Rios*, 143 F.3d at 671). Instead, the court held that its precedent was "more aligned with that of the Seventh and Tenth Circuits," which have held that the tax loss determined by considering the object of the offense should not be reduced by inadvertent mistakes such as unclaimed deductions. *Id.* at 6. See *United States* v. *Spencer*, 178 F.3d 1365, 1368 (10th Cir. 1999); *United States* v. *Chavin*, 316 F.3d 666, 678 (7th Cir. 2002).

ARGUMENT

Petitioner contends (Pet. 8-15) that the district court should have considered the overpayment of social-security tax by petitioner's family members in determining the amount of the tax loss for purposes of Sentencing Guidelines § 2T1.1(c). The court of appeals correctly rejected that claim. Petitioner identifies a conflict between the Second Circuit and the Fifth, Seventh, and Tenth Circuits in the interpretation of Section 2T1.1(c). That conflict can be resolved by the United States Sentencing Commission, and it does not warrant this Court's review. In any event, this case is a poor vehicle for addressing the conflict, because petitioner cannot show that he would prevail under the standard applied by any court of appeals. Further review is not warranted.

1. As an initial matter, review would be unwarranted even if the decision below directly conflicted with a decision of another court of appeals. This Court ordinarily does not review decisions interpreting the Sentencing Guidelines, because the Sentencing Commission can amend the Guidelines to eliminate a conflict or correct an error. See *Braxton* v. *United States*, 500 U.S. 344, 347-349 (1991). The Commission is charged by Congress with "periodically review[ing] the work of the courts" and making "whatever clarifying revisions to the Guidelines conflicting judicial decisions might suggest." *Id.* at 348; see *United States* v. *Booker*, 543 U.S. 220, 263 (2005) ("The Sentencing Commission will continue to collect and study appellate court decision-making. It will continue to modify its Guidelines in light of what it learns, thereby encouraging what it finds to be better sentencing practices."). Particularly because the Guidelines are now advisory, see *id.* at 243, this Court's review of the court of appeals' interpretations of the Guidelines is not warranted.

2. In *United States* v. *Martinez-Rios*, 143 F.3d 662, 671 (1998), the Second Circuit stated that the "determination of the tax loss" under Sentencing Guidelines § 2T1.1 requires "giving the defendant the benefit of legitimate but unclaimed deductions." Likewise, in *United States* v. *Gordon*, 291 F.3d 181, 187 (2002), cert. denied, 537 U.S. 1114 (2003), the Second Circuit held that a district court errs "when it refuse[s] to consider any potential unclaimed deductions in its sentencing analysis." But the court further held that the defendant "bears the full burden of proof" in establishing entitlement to legitimate, unclaimed deductions. *Ibid.* Thus, in *Gordon*, the error was harmless because the defendant "failed to prove that the money he received would

have been treated as [tax deductible] salary * * * if properly reported." *Ibid.* The court rejected as insufficient the defendant's assertion that "salary treatment was likely," instead holding that the defendant was required to demonstrate that the money he received actually "would have" been treated as salary. *Id.* at 188.

The Seventh and Tenth Circuits have rejected the Second Circuit's approach. The Guidelines define "tax loss" as "the total amount of loss that was the object of the offense (*i.e.*, the loss that would have resulted had the offense been successfully completed)." Sentencing Guidelines § 2T1.1(c)(1). That definition, the Seventh Circuit has held, refers to "the *attempted* or *intended* loss, rather than the *actual* loss to the government." *United States* v. *Chavin*, 316 F.3d 666, 677 (2002). Under that definition, "the object of [the defendant's] offense was the amount by which he underreported and fraudulently stated his tax liability on his return; reference to other unrelated mistakes on the return such as unclaimed deductions tells us nothing about the amount of loss to the government that his scheme intended to create." *Ibid.* Accord *United States* v. *Spencer*, 178 F.3d 1365, 1368-1369 (10th Cir. 1999).

3. This case does not implicate the conflict that exists between the decisions of the Second Circuit and those of the Seventh and Tenth Circuits. As petitioner acknowledges (Pet. 13), the case presents "a somewhat different issue" from that presented in the cases he cites. Petitioner "did not ask the district court to give him the benefit of legitimate, but unclaimed, deductions"; rather, petitioner states (*ibid.*), he asked that "excess of Social Security taxes he timely paid in per his family members' returns be deducted against the tax loss." Petitioner concedes that there is a difference be-

tween what the Second Circuit has permitted— allowing an unclaimed deduction as an offset to income that went unreported on the same tax return—and what petitioner seeks—reducing the intended income tax loss, dollar for dollar, by a different type of tax paid by a different person. Petitioner does not explain why the Second Circuit, applying *Martinez-Rios* and *Gordon*, would allow him to reduce his income tax loss by the putative overpayment of social-security taxes on his family members' returns.

Even if this case involved the same issue as the one on which the circuits have divided, it would be a poor vehicle for resolving it, because petitioner cannot prevail under either approach. Under the Second Circuit's approach, a defendant must prove actual entitlement to the claimed deduction. See *Gordon*, 291 F.3d at 187 (defendant "bears the full burden of proof" in establishing entitlement to unclaimed deductions). Here, petitioner failed to prove that the diverted funds were actually wages, either for petitioner or for his relatives. Gov't C.A. Br. 23. He also failed to prove that the social-security taxes paid in the names of his family members constituted an overpayment of *his* social-security taxes. *Id.* at 24-25. Because he did not prove entitlement to a credit for the social-security taxes in the district court, petitioner's sentence would be affirmed even in the Second Circuit.

4. Finally, petitioner challenges (Pet. 14) the court of appeals' determination that he "inadvertently caused payment of excess social security taxes." Pet. App. 6. Petitioner argues that, even under the definition of tax loss applied in the decision below, he is entitled to offset the overpayment of social-security taxes against the intended income tax loss, because the overpayment of social-security taxes was part of "the object of the of-

fense." In support of his theory, petitioner asserts (Pet. 14-15) that his "overpayment of Social Security taxes through his family members' returns was not an inadvertent consequence of his scheme," because his "scheme was not to use his family members' returns to avoid the payment of his taxes altogether but, rather, to conceal his total income and, inferentially, to pay his taxes at a lower rate."

That argument lacks merit. The fact that petitioner's fraudulent assignment of income to his relatives led them to pay social-security taxes does not mean that the overpayment of social-security tax was an "object of the offense." The object of an offense is the *illegal* objective that a defendant seeks to obtain, not a collateral benefit to the government flowing from other individuals' payment of a different type of tax. In any event, the court's factbound determination that petitioner "inadvertently caused payment of excess social security taxes" has no significance outside of the present case, and it does not warrant further review.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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